

**Tennessee Board of Regents
The University of Memphis**

**For the Year Ended
June 30, 2003**

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

April 15, 2004

The Honorable Phil Bredesen, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and

Dr. Shirley Raines, President
The University of Memphis
Memphis, Tennessee 38152

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis, for the year ended June 30, 2003. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
04/015

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
The University of Memphis
For the Year Ended June 30, 2003

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grants; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

**Audit Report
Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2003**

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**Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2003**

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

In 1909, The General Assembly of Tennessee enacted a general educational law providing for the establishment and maintenance of three normal schools in the state, one of which was to be located in Memphis. On September 15, 1912, West Tennessee State Normal School opened and, in 1925, became a senior college. On July 1, 1957, the institution was designated Memphis State University, and on July 1, 1994, the name was changed to The University of Memphis.

The university is a fully accredited institution of higher education and comprises the Cecil Humphreys School of Law, the graduate school, and the six undergraduate colleges: the College of Arts and Sciences, the Fogelman College of Business and Economics, the College of Education, the Herff College of Engineering, the College of Communication and Fine Arts, and University College.

ORGANIZATION

The governance of The University of Memphis is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The

chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. The University of Memphis is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the university's financial statements.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

November 21, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2003, and have issued our report thereon dated November 21, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

The Honorable John G. Morgan
November 21, 2003
Page Two

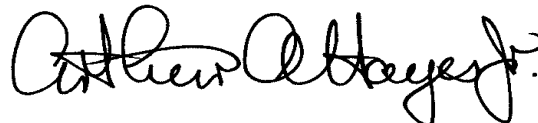
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting, which we have reported to the university's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes Jr.", with a stylized, cursive script.

Arthur A. Hayes, Jr., CPA,
Director

AAH/cj



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
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Independent Auditor's Report

November 21, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Board of Regents, The University of Memphis, as of June 30, 2003, and June 30, 2002, and the revenues, expenses, and changes in net assets and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

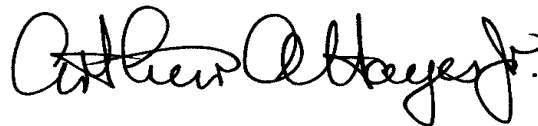
The Honorable John G. Morgan
November 21, 2003
Page Two

As discussed in Note 12, during the year ended June 30, 2002, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The university also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis on pages 8 through 18 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2003, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes Jr.", with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA,
Director

AAH/cj

The University of Memphis Management's Discussion and Analysis

This section of The University of Memphis' annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2003, with comparative information presented for the fiscal year ended June 30, 2002. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of management.

Using This Annual Report

This report consists of three basic financial statements. The Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows provide information on The University of Memphis as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Statement of Net Assets

(in thousands of dollars)

	<u>2003</u>	<u>2002</u>
Assets:		
Current assets	\$ 79,117	\$ 81,164
Capital assets, net	217,053	170,126
Other assets	42,114	44,619
Total assets	<u>338,284</u>	<u>295,909</u>

Liabilities:

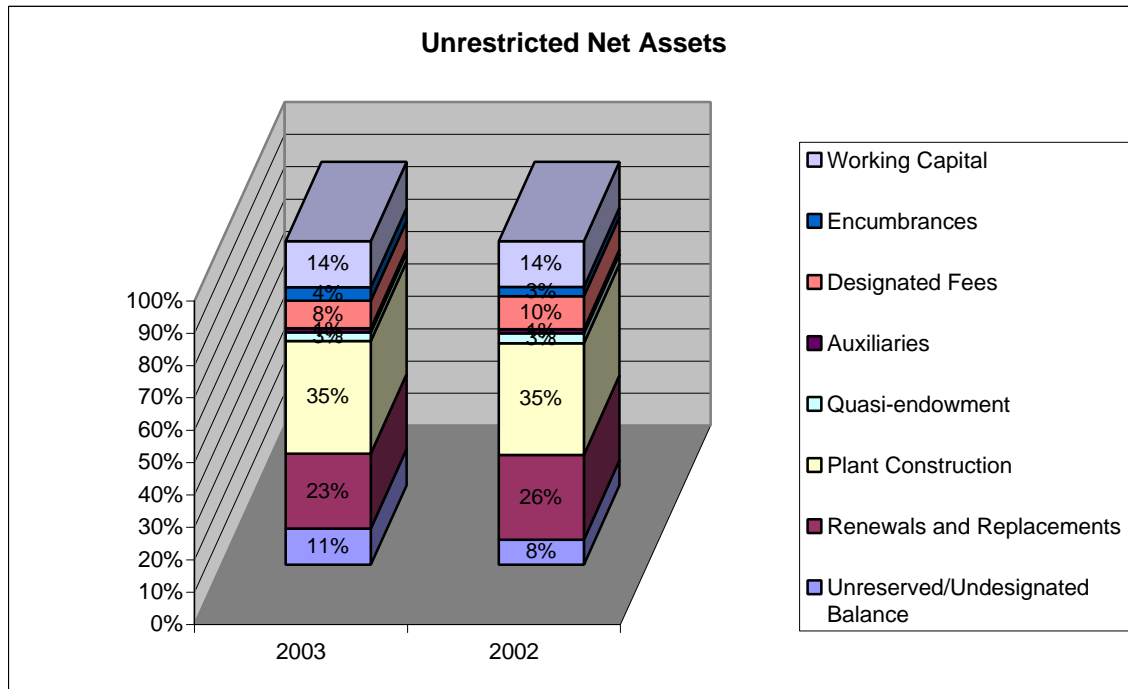
Current liabilities	39,765	40,677
Noncurrent liabilities	59,953	60,124
Total liabilities	<u>99,718</u>	<u>100,801</u>

Net Assets:

Invested in capital assets, net of related debt	161,245	113,104
Restricted - nonexpendable	4,125	4,159
Restricted - expendable	26,056	30,008
Unrestricted	47,140	47,837
Total net assets	<u>\$ 238,566</u>	<u>\$ 195,108</u>

- Capital assets, net of accumulated depreciation, and invested in capital assets, net of related debt, increased in 2003 due to the following:
 - A federal grant of \$29 million that deeded land, buildings, and improvements in Millington, Tennessee, to the University.
 - Increases in construction in progress including the following major projects: FedEx Technology Institute building - \$13.6 million; Athletic Training Center Modifications and Renovations - \$3.3 million; and Wilder Tower Renovations - \$1.9 million.
- Restricted – expendable net assets decreased in 2003 due to the following:
 - Decrease in capital project balances of \$3.2 million.
 - Decrease in loan balances of \$2.6 million due to prior year reclassification of federal loan balances from net assets to noncurrent liabilities – due to grantors.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as repairs and replacement of equipment, future debt service, quasi-endowments, capital projects, and student loans. The following graph shows the allocations:



There were no significant changes in the components of unrestricted net assets from 2002 to 2003.

The Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

Statement of Revenues, Expenses, and Changes in Net Assets

(in thousands of dollars)

	<u>2003</u>	<u>2002</u>
Operating revenues:		
Net tuition and fees	\$ 77,606	\$ 64,194
Grants and contracts	47,201	46,172
Auxiliary	12,489	13,103
Other	14,443	18,312
Total operating revenues	<u>151,739</u>	<u>141,781</u>
Operating expenses	<u>(280,902)</u>	<u>(253,939)</u>
Operating loss	<u>(129,163)</u>	<u>(112,158)</u>

Nonoperating revenues and expenses:

State appropriations	106,141	103,717
Gifts	15,445	11,924
Grants and contracts	251	-
Investment income	3,675	4,623
Other revenues and expenses	(258)	(1,952)
Total nonoperating revenues and expenses	<u>125,254</u>	<u>118,312</u>

Income (loss) before other

revenues, expenses, gains or losses	<u>(3,909)</u>	<u>6,154</u>
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Other revenues, expenses, gains, or losses:

Capital appropriations	18,675	14,414
Capital grants and gifts	29,011	-
Other	(319)	(8,644)
Total other revenues, expenses, gains, or losses	<u>47,367</u>	<u>5,770</u>

Increase in net assets	<u>43,458</u>	<u>11,924</u>
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Net assets at beginning year, as originally reported	195,108	360,676
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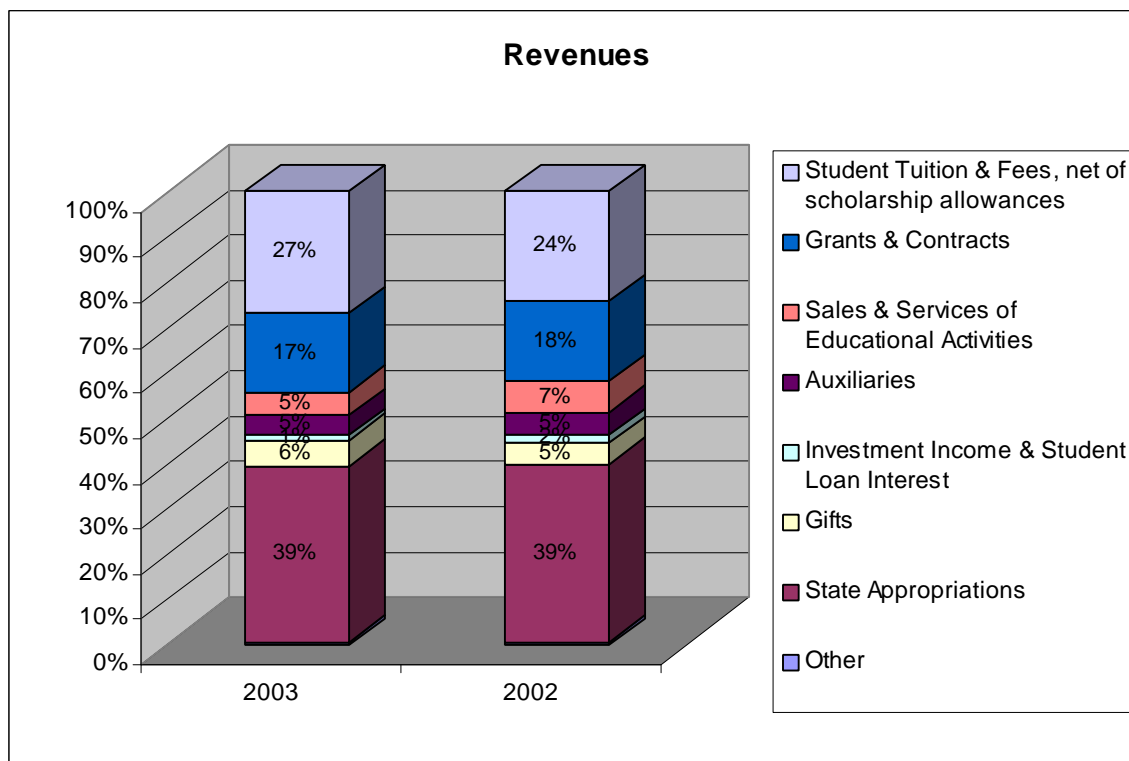
Cumulative effect of changes in accounting principle	<u>-</u>	<u>(177,492)</u>
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Net asset at beginning of period, restated	<u>195,108</u>	<u>183,184</u>
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Net assets at end of year	<u>\$ 238,566</u>	<u>\$ 195,108</u>
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Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating, excluding capital gifts and capital appropriations), which are used to fund the university's operating activities for the year ended June 30, 2003, and the year ended June 30, 2002.



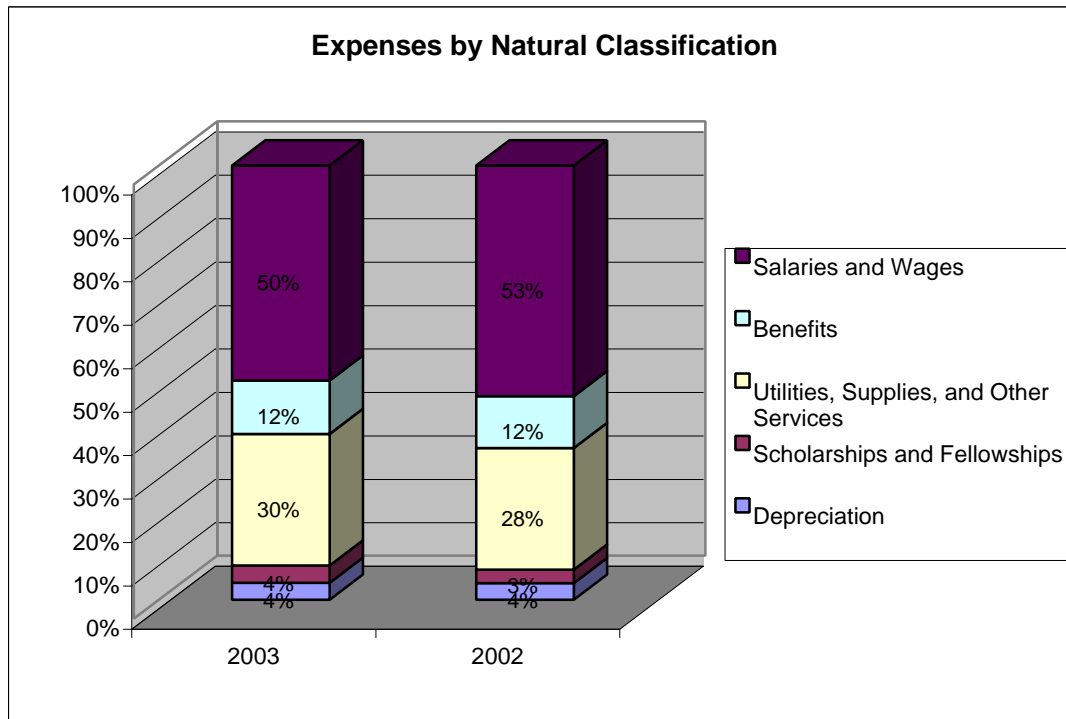
- The increase in student tuition and fees, net of scholarship allowances, is attributable to the following:
 - 7.5% tuition increase from the prior year.
 - Prior-period adjustment that understated fiscal year 2002 revenue by \$4.6 million (and overstated deferred revenue by the same amount).
- A decrease in revenues from sales and services of educational activities and a corresponding increase in gifts are attributable to a prior-year reclassification error resulting in an overstatement of fiscal year 2002 sales and services of educational activities of \$3.6 million and understatement of fiscal year 2002 gifts by the same amount.
- State appropriations were relatively unchanged from the prior year, due to a fiscal year 2003 5% impoundment, totaling \$5.4 million.

Expenses

Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below.

Natural Classification
(in thousands of dollars)

	2003	2002
Operating Expenses:		
Salaries and wages	\$ 139,019	\$ 134,814
Benefits	34,445	30,383
Utilities, supplies, and other services	84,998	71,081
Scholarships and fellowships	11,033	7,836
Depreciation	11,407	9,825
Total Operating Expenses	\$ 280,902	\$ 253,939

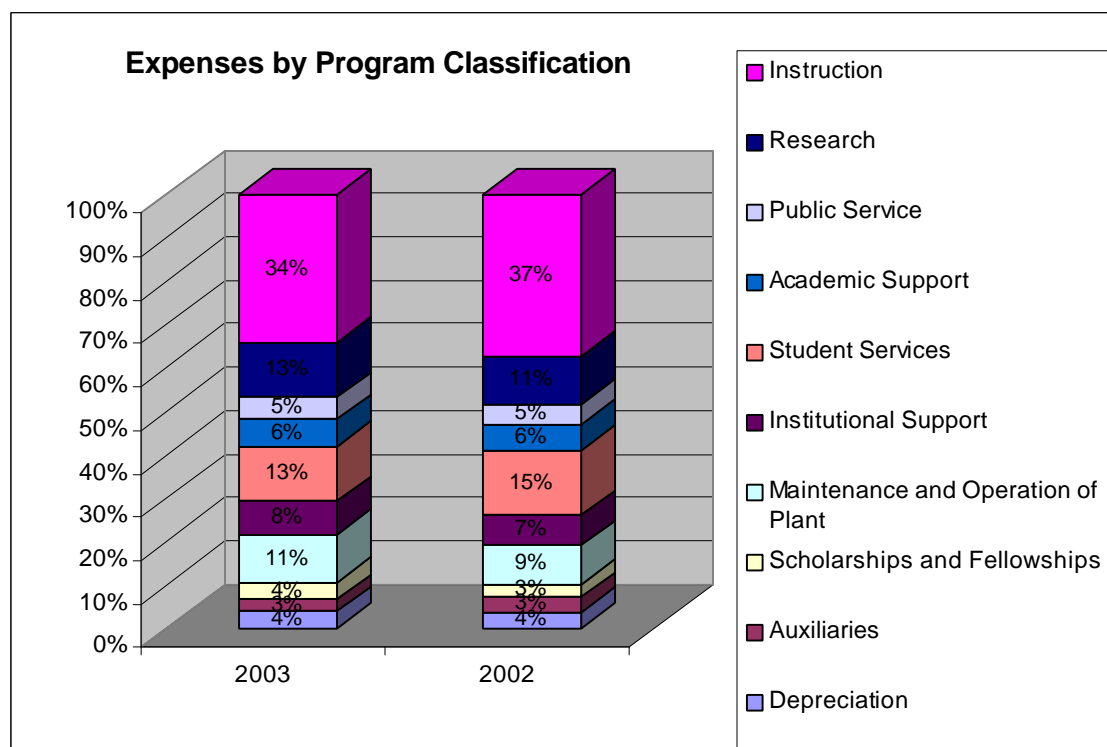


- Salaries and wages increased from the prior year as noted below:
 - A mid-year average faculty salary increase of 5% and staff increase of 2%.
 - Benefits increase of 13%, from increased salaries and health insurance costs.
- Utilities, supplies, and other services increased from the prior year as follows:

- Deferred plant maintenance projects increased from the prior year—Fume Hood Upgrades - \$3 million; various plant deferred maintenance - \$3 million.
- Utilities and fuel costs increased \$.6 million from the prior year.
- \$3 million increase in student laboratory computer and non-capital acquisitions.
- Scholarships and fellowships increased with the 7.5% increase in fees in addition to a \$1.4 million increase in restricted scholarships.

Program Classification
(in thousands of dollars)

	2003	2002
Operating Expenses:		
Instruction	\$ 96,144	\$ 94,988
Research	35,162	27,730
Public service	13,980	11,934
Academic support	17,397	15,150
Student services	36,469	38,143
Institutional support	20,843	17,181
Maintenance and operation of plant	30,509	22,632
Scholarships and fellowships	11,033	7,836
Auxiliaries	7,958	8,520
Depreciation	11,407	9,825
	<hr/>	<hr/>
Total Operating Expenses	\$ 280,902	\$ 253,939
	<hr/>	<hr/>



- Total instruction and research expenditures remained consistent with the prior year, with more effort dedicated to research efforts.
- Academic support expenditures increased from the prior year primarily due to the new FedEx Technology Institute Academic Learning Center and a reclassification of Nursing Dean activities out of instruction.
- Institutional support expenditures increased due to the timing of filling vacant positions. Additionally, network services expenditures increased as the university expands wireless capabilities and a new student ID system was acquired towards the end of 2003.
- Increases in deferred maintenance costs and utilities were responsible for the increase in maintenance and operation of plant from the prior year.

The Statement of Cash Flows

The Statement of Cash Flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statement of Cash Flows
(in thousands of dollars)

	2003	2002
Cash provided (used) by:		
Operating activities	\$ (113,938)	\$ (98,890)
Noncapital financing activities	123,358	116,598
Capital and related financing activities	(15,523)	(12,547)
Investing activities	3,720	9,850
	<hr/>	<hr/>
Net increase (decrease) in cash	(2,383)	15,011
	<hr/>	<hr/>
Cash, beginning of year	51,308	36,297
	<hr/>	<hr/>
Cash, end of year	\$ 48,925	\$ 51,308
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- Operating activities:
 - Increases in cash flow from the 7.5% tuition increase for fiscal year 2003 were used to fund increases in payments for employee salaries and benefits.
 - Payments to vendors and suppliers increased \$10 million from the prior year, caused by increased deferred maintenance and renewal and replacement projects and increased student laboratory and non-capital acquisitions.
 - Payments for scholarships and fellowships increased from the prior year due to the tuition increase and an increase in restricted federal programs.
- The change in noncapital financing activities represents increased gifts (\$2.5 million) and increased state appropriations (\$2.7 million).
- Cash provided from investing activities decreased from the prior year with decreased earnings on investments and an increased volume in investment purchases due to investment maturities.
- There was a small decrease in liquidity from the prior year.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2003, The University of Memphis had \$217.4 million invested in capital assets, net of accumulated depreciation of \$128.6 million. Depreciation charges totaled \$11.4 million for the current fiscal year. Details of these assets are shown below.

Schedule of Capital Assets, Net of Depreciation
(in thousands of dollars)

	<u>2003</u>	<u>2002</u>
Land	\$ 15,298	\$ 14,286
Land improvements & infrastructure	3,653	3,805
Buildings	130,000	100,058
Equipment	11,773	11,417
Library holdings	14,126	13,696
Projects in progress	42,203	26,864

- In the current year, the university received \$29 million in land and buildings in Millington, Tennessee, as a federal grant.
- Increases in projects in progress include:
 - FedEx Technology Institute building - \$13.6 million. Sources of funds include private and local city and county gifts and state appropriations.
 - Athletic Training Center Modifications - \$3.4 million. Private gifts are the primary source of funds.
 - Wilder Tower Renovations - \$1.9 million. The source of funding is state appropriations.

The three projects in progress mentioned above are scheduled for completion in fiscal year 2004. The \$23 million University Center Renovation project is scheduled to begin in fiscal year 2004. Primary funding sources for this project are \$10 million in local funds, including accumulated student debt service fees and residual funds from a completed project, and \$13 million in new debt to be repaid from existing and future student debt service fees (no increase in the current student debt service fee is needed). More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2003, the university had \$55.8 million in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt at Year-End
(in thousands of dollars)

	<u>2003</u>	<u>2002</u>
Bonds Payable	\$ 54,445	\$ 57,023
Commercial Paper	<u>1,363</u>	<u>-</u>
	<u>\$ 55,808</u>	<u>\$ 57,023</u>

New short-term debt of \$1.3 million was issued during the current year for the Athletic Training Center renovation. This debt is to be paid from future gifts pledged to the University of Memphis Foundation. Fitch, Moody's Investors Service, and Standard & Poor's have rated the Tennessee State School Bond Authority bonds AA, Aa3, and AA, respectively. Moody's Investors Service and Standard & Poor's have rated the commercial paper P-1 and A-1+, respectively.

Debt repayments of \$2.86 million were made during the year. More detailed information about the university's long-term liabilities is presented in Note 7 to the financial statements.

Economic Factors That Will Affect the Future

The economic position of the university is closely tied to that of the state. State funding for the university for 2004 was decreased \$9.6 million. The university implemented various cost-saving initiatives along with a 14% increase in student fees for 2004 to offset the loss in state appropriations. Recent increases in student fees have not significantly impacted enrollment, with enrollment steady for the past 10 years.

The university is not aware of any currently known facts, decisions, or conditions that are expected to have a significant impact on financial position or results of operations in the future.

Requests for Information

This financial report is designed to provide a general overview of the institution's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to David Zettergren, Assistant Vice President for Finance; Administration Building, Room 276; Memphis, TN 38152-3370.

**TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF NET ASSETS
JUNE 30, 2003, AND JUNE 30, 2002**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 3)	\$ 29,165,999.86	\$ 26,905,571.76
Short-term investments (Note 4)	24,210,662.92	27,595,495.64
Accounts, notes, and grants receivable (net) (Note 5)	24,152,368.46	25,561,657.84
Inventories (at lower of cost or market)	451,529.30	473,666.64
Prepaid expenses and deferred charges	632,275.11	187,736.01
Accrued interest receivable	504,443.11	440,178.62
Total current assets	<u>79,117,278.76</u>	<u>81,164,306.51</u>
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 3)	19,758,884.99	24,390,000.23
Investments (Note 4)	11,354,548.50	8,078,850.00
Accounts, notes, and grants receivable (net) (Note 5)	11,000,280.62	12,137,311.39
Prepaid expense	-	12,220.28
Capital assets (net) (Note 6)	217,053,458.74	170,126,347.84
Total noncurrent assets	<u>259,167,172.85</u>	<u>214,744,729.74</u>
Total assets	<u>338,284,451.61</u>	<u>295,909,036.25</u>
LIABILITIES		
Current liabilities:		
Accounts payable	9,966,651.46	7,126,078.21
Accrued liabilities	14,266,209.06	14,552,472.24
Student deposits	562,738.14	534,423.43
Deferred revenue	8,906,739.13	11,724,785.04
Compensated absences (Note 7)	1,847,080.21	2,702,420.09
Accrued interest payable	516,088.74	573,016.51
Long-term liabilities, current portion (Note 7)	3,216,409.90	2,906,708.37
Deposits held in custody for others	423,195.60	428,999.26
Other liabilities	59,910.36	128,331.73
Total current liabilities	<u>39,765,022.60</u>	<u>40,677,234.88</u>
Noncurrent liabilities:		
Compensated absences (Note 7)	4,850,362.83	3,582,277.79
Long-term liabilities (Note 7)	52,591,980.39	54,115,861.89
Due to grantors (Note 7)	2,511,158.12	2,425,688.08
Total noncurrent liabilities	<u>59,953,501.34</u>	<u>60,123,827.76</u>
Total liabilities	<u>99,718,523.94</u>	<u>100,801,062.64</u>
NET ASSETS		
Invested in capital assets, net of related debt	161,245,068.45	113,103,777.58
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	2,927,282.80	3,059,251.35
Other	1,198,180.81	1,099,317.71
Expendable:		
Scholarships and fellowships	1,824,986.40	2,066,368.21
Research	1,658,332.41	2,182,619.58
Instructional department uses	2,132,208.23	2,117,181.73
Loans	2,644,154.69	2,464,192.93
Capital projects	16,482,322.91	19,816,452.35
Debt service	205,874.11	327,412.53
Other	1,107,695.74	1,034,279.62
Unrestricted (Note 8)	47,139,821.12	47,837,120.02
Total net assets	<u>\$ 238,565,927.67</u>	<u>\$ 195,107,973.61</u>

The notes to the financial statements are an integral part of this statement.

**TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002**

	Year Ended June 30, 2003	Year Ended June 30, 2002
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of \$10,432,780.00 for the year ended June 30, 2003, and \$12,298,334.00 for the year ended June 30, 2002)	\$ 77,606,295.17	\$ 64,193,945.32
Governmental grants and contracts	36,083,614.89	32,511,604.40
Nongovernmental grants and contracts	11,117,112.63	13,660,046.39
Sales and services of educational departments	14,103,245.53	17,924,946.08
Auxiliary enterprises:		
Residential life (net of scholarship allowances of \$76,697.00 for the year ended June 30, 2003, and \$88,453.00 for the year ended June 30, 2002)	7,407,532.12	7,417,516.73
Bookstore	570,832.97	800,000.37
Food service	275,000.00	629,733.31
Other auxiliaries	4,235,503.53	4,255,752.45
Interest earned on loans to students	339,574.85	386,627.60
Total operating revenues	<u>151,738,711.69</u>	<u>141,780,172.65</u>
EXPENSES		
Operating expenses (Note 18):		
Salaries and wages	139,019,548.73	134,813,469.02
Benefits	34,444,837.47	30,383,416.42
Utilities, supplies, and other services	84,998,624.44	71,081,060.62
Scholarships and fellowships	11,032,400.54	7,835,742.11
Depreciation expense	11,406,685.86	9,824,818.43
Total operating expenses	<u>280,902,097.04</u>	<u>253,938,506.60</u>
Operating loss	<u>(129,163,385.35)</u>	<u>(112,158,333.95)</u>
NONOPERATING REVENUES (EXPENSES)		
State appropriations	106,141,400.00	103,717,366.67
Gifts	15,445,235.80	11,924,231.60
Grants and contracts	251,224.37	-
Investment income (net of investment expense of \$35,788.64 for the year ended June 30, 2003, and \$35,163.09 for the year ended June 30, 2002)	3,674,864.65	4,622,738.65
Interest on capital asset-related debt	(3,285,105.27)	(3,268,460.11)
Other nonoperating revenues (expenses)	3,026,391.60	1,316,851.08
Net nonoperating revenues	<u>125,254,011.15</u>	<u>118,312,727.89</u>
Gain (loss) before other revenues, expenses, gains, or losses	<u>(3,909,374.20)</u>	<u>6,154,393.94</u>
Capital appropriations	18,675,168.09	14,413,757.08
Capital grants and gifts	29,011,572.00	-
Other	(319,411.83)	(8,643,725.75)
Total other revenues	<u>47,367,328.26</u>	<u>5,770,031.33</u>
Increase (decrease) in net assets	<u>43,457,954.06</u>	<u>11,924,425.27</u>

**TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002**

	Year Ended June 30, 2003	Year Ended June 30, 2002
NET ASSETS		
Net assets - beginning of year, as originally reported	195,107,973.61	360,675,932.18
Cumulative effects of changes in accounting principle (Note 12)		
Adoption of capitalization criteria for buildings and additions	-	(3,227,893.82)
Adoption of depreciation for capital assets	-	(111,922,008.56)
Adoption of capitalization criteria for library holdings	-	(66,454,189.46)
Deferred revenue recognition	-	4,339,856.20
Prior audit adjustment	-	(228,148.20)
Net assets - beginning of year, as restated	195,107,973.61	183,183,548.34
Net assets - end of year	\$ 238,565,927.67	\$ 195,107,973.61

The notes to the financial statements are an integral part of this statement.

**TENNESSEE BOARD OF REGENTS
UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002**

	Year Ended <u>June 30, 2003</u>	Year Ended <u>June 30, 2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	\$ 77,194,424.48	\$ 63,396,369.23
Grants and contracts	47,466,840.27	45,805,850.33
Sales and services of educational activities	13,478,803.96	17,971,514.30
Payments to suppliers and vendors	(83,726,607.73)	(72,514,421.78)
Payments to employees	(138,694,666.11)	(131,420,437.88)
Payments for benefits	(34,032,092.31)	(30,082,153.72)
Payments for scholarships and fellowships	(11,032,400.54)	(6,312,173.13)
Loans issued to students and employees	(2,344,271.97)	(387,384.41)
Collection of loans from students and employees	3,798,377.28	404,905.60
Auxiliary enterprise charges:		
Residence halls	7,484,012.86	7,355,646.80
Bookstore	570,832.97	800,000.37
Food services	272,253.25	634,310.31
Other auxiliaries	4,280,393.20	4,453,967.22
Other receipts (payments)	1,345,836.06	1,004,434.43
Net cash used by operating activities	<u>(113,938,264.33)</u>	<u>(98,889,572.33)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	106,906,100.00	103,717,366.67
Gifts and grants received for other than capital or endowment purposes	13,434,758.46	11,714,031.32
Federal student loan receipts	57,131,166.32	51,610,097.00
Federal student loan disbursements	(57,131,166.32)	(51,610,097.00)
Changes in deposits held for others	(5,803.66)	(75,695.99)
Other noncapital financing receipts (payments)	3,023,249.24	1,242,287.93
Net cash provided by noncapital financing activities	<u>123,358,304.04</u>	<u>116,597,989.93</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	1,645,699.79	5,968,673.25
Capital - state appropriations	18,675,168.09	14,413,757.08
Capital grants and gifts received	29,011,572.00	-
Proceeds from sale of capital assets	2,660.00	23,750.75
Purchases of capital assets and construction	(58,655,868.59)	(26,133,095.60)
Principal paid on capital debt and lease	(2,859,879.76)	-
Interest paid on capital debt and lease	(3,342,033.04)	(2,695,443.60)
Deposit with trustee	-	(12,220.28)
Other capital and related financing receipts (payments)	-	(4,112,541.53)
Net cash used by capital and related financing activities	<u>(15,522,681.51)</u>	<u>(12,547,119.93)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	3,533,796.84	4,758,771.46
Income on investments	3,461,636.04	5,091,166.20
Purchases of investments	(3,275,698.50)	-
Net cash provided by investing activities	<u>3,719,734.38</u>	<u>9,849,937.66</u>
Net increase in cash and cash equivalents	(2,382,907.42)	15,011,235.33
Cash and cash equivalents - beginning of year	51,307,792.27	36,296,556.94
Cash and cash equivalents - end of year	<u>\$ 48,924,884.85</u>	<u>\$ 51,307,792.27</u>

**TENNESSEE BOARD OF REGENTS
UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002**

	Year Ended <u>June 30, 2003</u>	Year Ended <u>June 30, 2002</u>
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (129,163,385.35)	\$ (112,158,333.95)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	11,406,685.86	9,824,818.43
Gifts in-kind	1,674,506.32	193,151.28
Change in assets and liabilities:		
Receivables, net	1,172,589.38	(2,673,853.44)
Inventories	22,137.34	(45,198.65)
Prepaid/deferred items	(444,539.10)	(57,744.81)
Other Assets	1,137,030.77	-
Accounts payable	2,840,573.25	2,037,344.18
Accrued liabilities	(286,263.18)	3,244,968.38
Deferred revenue	1,830,890.15	(4,593,892.91)
Deposits	28,314.71	31,625.65
Compensated absences	412,745.16	301,262.70
Due to grantors	85,470.04	(2,412,536.57)
Loans to students and employees	(689,672.77)	17,521.19
Prior audit adjustment	(4,033,871.27)	-
Other	68,524.36	3,440,112.90
Net cash used by operating activities	\$ <u>(113,938,264.33)</u>	\$ <u>(102,850,755.62)</u>
Noncash transactions		
Gifts-in-kind operating	\$ 1,674,506.32	\$ 193,151.28
Gifts-in-kind Capital	\$ -	\$ 17,049.00
Unrealized gains/losses on investments	\$ 148,964.12	\$ 335,053.68

The notes to the financial statements are an integral part of this statement.

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements
June 30, 2003, and June 30, 2002**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. This was followed in November 1999 by GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The financial presentation required by those statements provides a comprehensive, entity-wide perspective of the university's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes made in order to comply with the new requirements include (1) adoption of depreciation on capital assets and (2) reporting summer school revenues and expenses between fiscal years rather than in one fiscal year.

Basis of Accounting

For financial statement purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) scholarships and fellowships; (4) depreciation; and (5) utilities, supplies, and other services.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; and (5) gifts.

When both restricted and unrestricted resources are available for use, generally it is the university's policy to use the unrestricted resources first.

Inventories

Inventories are valued at the lower of cost or market. All other items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are reported in the statement of net assets.

Capital Assets

Capital assets, which include property, plant, equipment, and library holdings, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

A capitalization threshold of \$100,000 is used for buildings, and \$50,000 is used for infrastructure. Equipment is capitalized when the unit acquisition cost is \$5,000 or greater. The capitalization threshold for additions and improvements to buildings and land is set at \$50,000.

These assets, with the exception of land, are depreciated using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Assets

The university's net assets are classified as follows:

Invested in capital assets, net of related debt – This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Nonexpendable restricted net assets – Nonexpendable restricted net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

Expendable restricted net assets – Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets – Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

NOTE 2. CASH

This classification includes demand deposits and petty cash on hand. At June 30, 2003, cash consisted of \$6,680,139.26 in bank accounts, \$74,010.00 of petty cash on hand, \$35,296,059.01 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and \$6,874,676.58 in LGIP deposits for capital projects. At June 30, 2002, cash consisted of \$11,068,115.95 in bank accounts, \$73,310.00 of petty cash on hand, \$30,495,257.14 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and \$9,658,888.90 in LGIP deposits for capital projects.

LGIP deposits for capital projects - Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

NOTE 3. DEPOSITS

Some of the university's deposits are in financial institutions that participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement,

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

At June 30, 2003, the carrying amount of the university's deposits in financial institutions participating in the collateral pool was \$6,680,139.26, and the bank balance including accrued interest was \$9,220,126.38. The bank balance was insured.

At June 30, 2002, the carrying amount of the university's deposits in financial institutions participating in the collateral pool was \$11,068,115.95, and the bank balance including accrued interest was \$13,546,700.26. The bank balance was insured.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. Tennessee Board of Regents policies require that the market value of collateral pledged equal 115%, 100%, or 90% of the uninsured deposits at financial institutions participating in the collateral pool and 105% of the uninsured deposits at all other financial institutions. The pledge level for financial institutions participating in the collateral pool is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level.

Deposits with financial institutions are required to be categorized to indicate the level of risk assumed by the university. Category 1 consists of deposits that are insured or collateralized with securities held by the university or by its agent in the university's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the university's name. Category 3 deposits are uncollateralized. This category includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the university's name.

At June 30, 2003, the carrying amount of the university's deposits was \$6,880,139.26, and the bank balance including accrued interest was \$9,422,240.83. The entire bank balance of \$9,422,240.83 was Category 1.

At June 30, 2002, the carrying amount of the university's deposits was \$11,268,115.95, and the bank balance including accrued interest was \$13,748,509.14. The entire bank balance of \$13,748,509.14 was Category 1.

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

The university also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 4. INVESTMENTS

The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified.

All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase. Certificates of deposit have been included with other deposits in Note 3 to determine the adequacy of collateral security pledged.

The university's investments are categorized below to indicate the level of risk assumed by the university at year-end. Category 1 consists of insured or registered investments or investments for which the securities are held by the university or its agent in the university's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparty's/counterparties' trust department or agent in the university's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the university's name.

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Category 1:		
U.S. government securities	\$ 28,374,609.75	\$ 31,487,028.11
Commercial paper	6,990,601.67	3,987,317.53
Investments not susceptible to credit risk categorization:		
Certificates of deposit classified as investments	<u>200,000.00</u>	<u>200,000.00</u>
Total	<u>\$ 35,565,211.42</u>	<u>\$ 35,674,345.64</u>

NOTE 5. RECEIVABLES

Receivables included the following:

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Student accounts receivable	\$ 8,028,646.80	\$ 9,700,802.73
Grants receivable	12,570,964.88	12,202,009.13
Notes receivable	1,681,156.19	3,572,272.00
State appropriation receivable	236,700.00	-
Other receivables	<u>15,387,387.41</u>	<u>15,677,525.01</u>
Subtotal	37,904,855.28	41,152,608.87
Less allowance for doubtful accounts	<u>(5,329,164.39)</u>	<u>(5,909,052.72)</u>
Total receivables	<u>\$ 32,575,690.89</u>	<u>\$ 35,243,556.15</u>

Federal Perkins Loan Program funds included the following:

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Perkins loans receivable	\$ 3,607,060.22	\$ 3,539,815.73
Less allowance for doubtful accounts	<u>(1,030,102.03)</u>	<u>(1,084,402.65)</u>
Total	<u>\$ 2,576,958.19</u>	<u>\$ 2,455,413.08</u>

**Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

NOTE 6. CAPITAL ASSETS

Capital asset activity for the university for the year ended June 30, 2003, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land	\$14,286,239.50	\$ 1,012,284.00	\$ -	\$ -	\$ 15,298,523.50
Land improvements and infrastructure	14,465,804.80	227,412.00	-	-	14,693,216.80
Buildings	171,922,220.61	29,872,304.13	5,155,790.08	-	206,950,314.82
Equipment	36,072,971.63	3,665,635.41	-	2,567,394.23	37,171,212.81
Library holdings	28,261,542.95	3,365,212.94	-	2,280,633.85	29,346,122.04
Projects in progress	<u>26,864,395.34</u>	<u>20,510,360.11</u>	<u>(5,155,790.08)</u>	<u>16,272.15</u>	<u>42,202,693.22</u>
Total	<u>291,873,174.83</u>	<u>58,653,208.59</u>	<u>-</u>	<u>4,864,300.23</u>	<u>345,662,083.19</u>
Less accum. depreciation:					
Land improvements and infrastructure	10,660,561.27	379,907.74	-	-	11,040,469.01
Buildings	71,864,273.12	5,085,555.57	-	-	76,949,828.69
Equipment	24,655,766.42	3,006,610.35	-	2,264,254.55	25,398,122.22
Library holdings	<u>14,566,226.18</u>	<u>2,934,612.20</u>	<u>-</u>	<u>2,280,633.85</u>	<u>15,220,204.53</u>
Total accum. depreciation	<u>121,746,826.99</u>	<u>11,406,685.86</u>	<u>-</u>	<u>4,544,888.40</u>	<u>128,608,624.45</u>
Capital assets, net	<u>\$170,126,347.84</u>	<u>\$ 47,246,522.73</u>	<u>\$ -</u>	<u>\$ 319,411.83</u>	<u>\$ 217,053,458.74</u>

Capital asset activity for the university for the year ended June 30, 2002, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending Balance</u>
Land	\$14,299,839.50	\$ -	\$ -	\$ 13,600.00	\$ 14,286,239.50
Land improvements and infrastructure	14,465,804.80	-	-	-	14,465,804.80
Buildings	159,715,991.05	6,621,492.37	5,639,137.19	54,400.00	171,922,220.61
Equipment	39,338,968.34	2,884,040.96	-	6,150,037.67	36,072,971.63
Library holdings	24,931,237.40	3,330,305.55	-	2,280,633.85	25,980,909.10
Projects in progress	<u>15,800,152.93</u>	<u>16,703,379.60</u>	<u>(5,639,137.19)</u>	<u>-</u>	<u>26,864,395.34</u>

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Total	<u>268,551,994.02</u>	<u>29,539,218.48</u>	<u>-</u>	<u>8,498,671.52</u>	<u>289,592,540.98</u>
Less accum. depreciation:					
Land improvements and infrastructure	10,288,187.77	372,373.50	-	-	10,660,561.27
Buildings	67,880,360.13	3,983,912.99	-	-	71,864,273.12
Equipment	22,013,388.78	2,642,377.64	-	-	24,655,766.42
Library holdings	<u>11,740,071.88</u>	<u>2,826,154.30</u>	<u>-</u>	<u>2,280,633.85</u>	<u>12,285,592.33</u>
Total accum. depreciation	<u>111,922,008.56</u>	<u>9,824,818.43</u>	<u>-</u>	<u>2,280,633.85</u>	<u>119,466,193.14</u>
Capital assets, net	<u>\$156,629,985.46</u>	<u>\$ 19,714,400.05</u>	<u>\$ -</u>	<u>\$ 6,218,037.67</u>	<u>\$ 170,126,347.84</u>

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2003, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Payables:					
Bonds	\$ 57,022,570.26	\$ 282,572.72	\$ 2,859,879.76	\$54,445,263.22	\$ 3,216,409.90
Commercial paper	<u>-</u>	<u>1,363,127.07</u>	<u>-</u>	<u>1,363,127.07</u>	<u>-</u>
Subtotal	<u>57,022,570.26</u>	<u>1,645,699.79</u>	<u>2,859,879.76</u>	<u>55,808,390.29</u>	<u>3,216,409.90</u>
Other liabilities:					
Compensated absences	6,284,697.88	5,368,852.99	4,956,107.83	6,697,443.04	1,847,080.21
Due to grantors	<u>2,425,688.08</u>	<u>123,071.50</u>	<u>37,601.46</u>	<u>2,511,158.12</u>	<u>-</u>
Subtotal	<u>8,710,385.96</u>	<u>5,491,924.49</u>	<u>4,993,709.29</u>	<u>9,208,601.16</u>	<u>1,847,080.21</u>
Total long-term liabilities	<u>\$ 65,732,956.22</u>	<u>\$ 7,137,624.28</u>	<u>\$ 7,853,589.05</u>	<u>\$65,016,991.45</u>	<u>\$ 5,063,490.11</u>

Long-term liabilities activity for the year ended June 30, 2002, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Payables:					
Bonds	\$ 49,796,587.88	\$ 9,816,939.39	\$ 2,590,957.01	\$57,022,570.26	\$ 2,906,708.37
Commercial paper	<u>1,257,309.13</u>	<u>-</u>	<u>1,257,309.13</u>	<u>-</u>	<u>-</u>
Subtotal	<u>51,053,897.01</u>	<u>9,816,939.39</u>	<u>3,848,266.14</u>	<u>57,022,570.26</u>	<u>2,906,708.37</u>

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Other liabilities:					
Compensated absences	5,983,435.18	5,203,327.05	4,902,064.35	6,284,697.88	2,702,420.09
Due to grantors	<u>2,330,136.42</u>	<u>139,785.05</u>	<u>44,233.39</u>	<u>2,425,688.08</u>	<u>-</u>
Subtotal	<u>8,313,571.60</u>	<u>5,343,112.10</u>	<u>4,946,297.74</u>	<u>8,710,385.96</u>	<u>2,702,420.09</u>
Total long-term liabilities	<u>\$ 59,367,468.61</u>	<u>\$15,160,051.49</u>	<u>\$ 8,794,563.88</u>	<u>\$65,732,956.22</u>	<u>\$ 5,609,128.46</u>

Bonds Payable

Bond issues, with interest rates ranging from 3% to 7.15% for Tennessee State School Bond Authority bonds, are due serially to 2032 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority reported on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was \$663,968.89 at June 30, 2003, and \$663,968.89 at June 30, 2002.

Debt service requirements to maturity for bonds payable at June 30, 2003, are as follows:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 3,216,409.90	\$ 3,074,605.23	\$ 6,291,015.13
2005	2,717,473.24	2,894,057.91	5,611,531.15
2006	2,539,453.76	2,739,625.16	5,279,078.92
2007	2,703,058.28	2,587,212.41	5,290,270.69
2008	2,862,313.24	2,428,677.38	5,290,990.62
2009-2013	10,990,397.23	9,742,171.81	20,732,569.04
2014-2018	7,441,567.17	7,475,927.20	14,917,494.37
2019-2023	8,578,261.39	5,326,549.09	13,904,810.48
2024-2028	9,532,805.31	2,939,818.10	12,472,623.41
2029-2032	<u>3,863,523.70</u>	<u>414,325.32</u>	<u>4,277,849.02</u>
Total	<u>\$ 54,445,263.22</u>	<u>\$ 39,622,969.61</u>	<u>\$ 94,068,232.83</u>

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Commercial paper

The Tennessee State School Bond Authority also authorized the issuance of commercial paper to finance the costs of various capital projects. The amount issued for projects at the university was \$1,363,127.07 at June 30, 2003, and zero at June 30, 2002.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

NOTE 8. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated or reserved for specific purposes. The unrestricted net assets are composed of the following:

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Working capital	\$ 6,720,040.22	\$ 6,334,263.77
Encumbrances	1,929,433.87	1,348,289.02
Designated fees	3,995,943.67	4,805,509.30
Auxiliaries	628,308.29	355,699.53
Quasi-endowment	1,247,639.51	1,447,639.51
Plant construction	16,452,508.78	16,257,556.07
Renewal and replacement of equipment	10,876,938.24	12,381,507.05
Unreserved/undesignated	<u>5,289,008.54</u>	<u>4,906,655.77</u>
Total	<u>\$ 47,139,821.12</u>	<u>\$ 47,837,120.02</u>

NOTE 9. ENDOWMENTS

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its power to

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spend net appreciation, the university is required to consider the university's long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation spent is required to be spent for the purposes for which the endowment was established.

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, 4.75% of a three-year moving average of the fair value of endowment investments has been authorized for expenditure. The remaining amount, if any, is retained for use in future years when the spending plan exceeds current year investment income, or is returned to corpus in accordance with the terms of the endowment agreement. At June 30, 2003, investment income of \$5,559,780.57 is available to be spent, which is all restricted to specific purposes as determined by the terms of the endowment.

NOTE 10. PENSION PLANS

A. Defined Benefit Plans

Tennessee Consolidated Retirement System

Plan Description - The university contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

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Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 7.29% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2003, 2002, and 2001 were \$3,398,360.32, \$2,927,856.69, and \$3,138,311.69. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was \$7,048,162.33 for the year ended June 30, 2003, and \$6,681,501.65 for the year ended June 30, 2002. Contributions met the requirements for each year.

NOTE 11. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available

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at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 12. CUMULATIVE EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2002, the university implemented GASB Statement 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management’s Discussion and Analysis—for Public Colleges and Universities*. As a result of this implementation, the university was required to make changes in certain accounting principles, specifically the (1) adoption of capitalization criteria of \$100,000 and \$50,000 for buildings and additions, respectively; (2) adoption of depreciation on capital assets; (3) recording of certain summer semester revenues between fiscal years rather than in the fiscal year in which the semester was predominantly conducted; and (4) reclassification of the U.S. government grants refundable amount as a liability. The cumulative effects of these changes on net assets are shown below:

Adoption of capitalization criteria for buildings and additions	\$ (3,227,893.82)
Adoption of depreciation on capital assets	\$ (111,922,008.56)
Adoption of capitalization criteria for library holdings	\$ (66,454,189.46)
Deferred revenue recognition	\$ 4,339,856.20

NOTE 13. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property losses above \$5 million per year and surety bond coverage on the state’s officials and employees. In the past three fiscal years, the state has had no claims filed with the commercial insurer. A designation for incurred losses in the amount of \$3.271 million at June 30, 2003, was established in the state’s general fund to provide for any property losses not covered by the commercial insurance.

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At June 30, 2003, the scheduled coverage for the university was \$452,832,500.00 for buildings and \$288,220,900.00 for contents. At June 30, 2002, the scheduled coverage for the university was \$427,521,300.00 for buildings and \$288,868,900.00 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The university participates in the Claims Award Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Since the university participates in the Claims Award Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to \$300,000 per person and \$1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Claims Award Fund.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 14. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there

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is no liability for sick leave at June 30. The dollar amount of unused sick leave was \$58,246,071.92 at June 30, 2003, and \$55,213,498.56 at June 30, 2002.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were \$1,823,695.24 and for personal property were \$382,123.82 for the year ended June 30, 2003. Comparative amounts for the year ended June 30, 2002, were \$1,524,706.20 and \$350,863.01. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2003, outstanding commitments under construction contracts totaled \$11,143,239.30 for the FedEx Technology Institute, University Center renovation, Athletic Training Center Addition and Modifications, and Fume Hood Upgrades of which \$2,339,070.25 will be funded by future state capital outlay appropriations.

Litigation - The university is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

NOTE 15. AFFILIATED ENTITY NOT INCLUDED

The university is the sole beneficiary of The University of Memphis Foundation. A board independent of the university controls this private, nonprofit foundation. The financial records, investments, and other financial transactions are not handled by the university, and these amounts are not included in the university's financial statements. As reported in the foundation's most recently audited financial report, at June 30, 2002, the foundation's assets totaled \$56,288,800.00, liabilities were \$1,801,829.00, and the fund balance amounted to \$54,486,971.00.

NOTE 16. CHAIRS OF EXCELLENCE

The university had \$54,584,937.18 on deposit at June 30, 2003, and \$53,647,404.14 on deposit at June 30, 2002, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

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NOTE 17. FUNDS HELD IN TRUST BY OTHERS

The university is a beneficiary under the Van Vleet, the Mike Driver, the Pope M. Farrington, the C. M. Gooch, and the Herbert Herff trusts. The underlying assets are not considered assets of the university and are not included in the university's financial statements. The university received \$896,674.83 from these funds during the year ended June 30, 2003, and \$748,016.02 during the year ended June 30, 2002.

NOTE 18. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2003, are as follows:

Functional Classifications	Natural Classification					Total
	Salaries	Benefits	Other Operating	Scholarships	Depreciation	
Instruction	\$62,019,123.22	\$13,530,671.43	\$20,594,337.97	\$ -	\$ -	\$ 96,144,132.62
Research	22,474,118.23	5,253,344.12	7,434,436.30	-	-	35,161,898.65
Public service	5,916,997.39	1,439,194.29	6,623,888.85	-	-	13,980,080.53
Academic support	14,273,296.61	4,073,555.62	(949,202.96)	-	-	17,397,649.27
Student services	12,790,652.78	3,530,362.72	20,148,038.16	-	-	36,469,053.66
Institutional support	11,589,624.95	3,336,192.63	5,917,187.62	-	-	20,843,005.20
Operation & maint.	8,143,522.56	2,867,054.78	19,499,074.06	-	-	30,509,651.40
Scholar. & fellow.	-	-	-	11,032,400.54	-	11,032,400.54
Auxiliary	1,812,212.99	414,461.88	5,730,864.44	-	-	7,957,539.31
Depreciation	-	-	-	-	11,406,685.86	11,406,685.86
Total	<u>\$139,019,548.73</u>	<u>\$34,444,837.47</u>	<u>\$84,998,624.44</u>	<u>\$11,032,400.54</u>	<u>\$11,406,685.86</u>	<u>\$ 280,902,097.04</u>

The university's operating expenses by functional classification for the year ended June 30, 2002, are as follows:

Functional Classification	Natural Classification					Total
	Salaries	Benefits	Other Operating	Scholarships	Depreciation	
Instruction	\$ 65,421,279.90	\$13,581,914.64	\$15,985,036.24	\$ -	\$ -	\$ 94,988,230.78
Research	17,853,812.16	3,469,828.39	6,405,786.33	-	-	27,729,426.88
Public service	6,073,813.01	1,266,342.92	4,593,903.71	-	-	11,934,059.64
Academic support	12,844,520.77	3,322,219.66	(1,016,875.12)	-	-	15,149,865.31
Student services	12,290,138.41	3,199,862.76	22,653,396.22	-	-	38,143,397.39
Institutional support	10,673,631.01	2,762,272.15	3,745,137.92	-	-	17,181,041.08

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Operation & maint.	7,695,752.85	2,431,259.26	12,505,212.34	-	-	22,632,224.45
Scholar. & fellow.	-	-	-	7,835,742.11	-	7,835,742.11
Auxiliary	1,960,520.91	349,716.64	6,209,462.98	-	-	8,519,700.53
Depreciation	-	-	-	-	9,824,818.43	9,824,818.43
Total	<u>\$134,813,469.02</u>	<u>\$30,383,416.42</u>	<u>\$71,081,060.62</u>	<u>\$ 7,835,742.11</u>	<u>\$9,824,818.43</u>	<u>\$253,938,506.60</u>

NOTE 19. PRIOR-YEAR RESTATEMENT

Due to changes in presentation made by the university for the year ended June 30, 2003, some reclassifications were made in the prior-year financial statements for comparative purposes. The LGIP deposit – capital projects was reclassified as noncurrent cash. The TSSBA interest rate reserve, which was previously shown as deposit with trustee, was reclassified as prepaid expense. Also, the note disclosure for unrestricted net assets was changed to show all of the components rather than just the designated amounts. In addition, an error was noted involving a prior adjustment. Thus, on Exhibit B, student tuition and fees decreased by \$3,961,183.29 and deferred revenue recognition increased by \$3,961,183.29, and on Exhibit C, tuition and fees decreased by \$3,961,183.29 and other receipts (payments) increased by \$3,961,183.29.